? India Considers Qualified MFN Clause to Balance Investor Protection, FDI Attractiveness and Regulatory Autonomy

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Recent Developments:

- India is considering a **broader restructuring of its Bilateral Investment Treaty (BIT) framework**, including the introduction of a **Qualified Most Favoured Nation (MFN) provision** instead of restoring the open-ended MFN approach removed under the **2015 Model BIT**.
- The proposed reforms seek to make India's investment regime more predictable for foreign investors while preserving the **regulatory autonomy of the State**.
- India currently has an active and evolving network of international investment agreements; UNCTAD's database records recently concluded BITs with countries including **Israel, Uzbekistan and the United Arab Emirates**, underlining the continuing importance of investment treaty policy.
- The reform debate is also significant because India has faced multiple treaty-based investor-State disputes, highlighting the need to balance **investor confidence, dispute management and sovereign policy space**.

Bilateral Investment Treaty (BIT):

Meaning and Purpose:

- A **Bilateral Investment Treaty (BIT)** is an agreement between two countries that establishes reciprocal rules for the **protection and treatment of investments** made by investors of one country in the territory of the other country.
- BITs aim to reduce political and regulatory uncertainty by providing foreign investors with a predictable legal framework while defining the obligations and policy space of the host State.
- Such treaties are an important component of the wider system of **International Investment Agreements (IIAs)**, which regulate cross-border investment relationships.

Major Areas Covered by BITs:

- **Non-discrimination:** Investors are generally protected against discriminatory treatment compared with similarly situated domestic or foreign investors.
- **Expropriation:** Treaties may regulate direct or indirect State actions that substantially deprive investors of the value or control of their investments.
- **Fair and Equitable Treatment (FET):** Traditional BITs often contain obligations requiring a certain minimum standard of treatment for foreign investors.
- **Transfer of Funds:** BITs may protect the ability of investors to transfer investment-related funds, profits and returns subject to treaty conditions.
- **Investor-State Dispute Settlement (ISDS):** Certain treaties allow foreign investors to initiate international arbitration against the host State for alleged treaty violations.

India's 2015 Model BIT:

Background:

- India adopted a new **Model BIT in 2015** after concerns emerged regarding the broad interpretation of investor protection provisions under earlier investment treaties.
- The Model BIT was designed to move away from excessively open-ended treaty obligations and provide greater protection to the **State's regulatory authority**.
- The Department of Economic Affairs continues to maintain the 2015 Model BIT as the central reference framework for India's investment treaty policy.

Key Policy Approach:

- The 2015 Model BIT adopted a comparatively cautious approach towards **MFN treatment, FET obligations and ISDS**.
- India avoided an unrestricted MFN clause that could enable investors to rely on more favourable provisions contained in unrelated treaties concluded with third countries.
- The framework sought to ensure that India's treaty obligations remained primarily limited to provisions **expressly negotiated by the concerned treaty partners**.
- This approach reflected India's attempt to prevent international arbitral tribunals from expanding treaty commitments beyond the intended scope of the agreement.

Most Favoured Nation (MFN) Principle:

Meaning:

- The **Most Favoured Nation (MFN) principle** generally requires a country to provide investors from one treaty partner treatment that is **no less favourable** than the treatment provided to investors from another country in comparable circumstances.
- The principle is based on **non-discrimination among foreign investors** and seeks to prevent arbitrary preferences between investors from different countries.

Illustrative Example:

- Suppose **Country A** provides more favourable investment protection to investors from **Country B** under a later treaty.
- If investors from **Country C** have access to an applicable and broadly drafted MFN clause in their treaty with Country A, they may attempt to claim similar treatment.
- This possibility of drawing favourable provisions from third-country treaties is often described as the **importation of treaty provisions**.

Why Broad MFN Clauses Became Controversial:

- Investment tribunals have adopted different interpretations regarding whether an MFN clause can be used to import not only substantive protections but also **procedural provisions relating to dispute settlement**.
- Such interpretation may allow investors to seek access to more favourable provisions that were never specifically negotiated between the two States concerned.
- UNCTAD has identified the use of MFN clauses to import more favourable ISDS provisions from third-country treaties as a major source of treaty interpretation controversy.

Qualified MFN Provision:

Meaning:

- A **Qualified MFN clause** would retain the principle of non-discrimination while placing explicit limitations on the scope and operation of MFN treatment.
- It represents a middle path between **completely unrestricted MFN treatment** and the complete absence of an MFN provision.

Possible Safeguards:

- The revised clause could explicitly specify **which categories of treaty provisions can be relied upon through MFN treatment**.
- It could clarify whether investors can import **substantive protections, procedural rights, or neither category** from third-country treaties.
- It could specify whether the provision applies to **future treaties, existing treaties or both**.
- It could prevent the retrospective application of favourable treaty provisions unless expressly permitted.
- It could clarify whether settled disputes can be reopened through subsequently negotiated treaty protections.
- It could define the relevant **"like circumstances"** or comparable-investor standard for determining discrimination.
- It could expressly exclude the use of MFN provisions for expanding **ISDS jurisdiction or dispute-settlement procedures**.

Significance:

- A Qualified MFN clause can provide foreign investors with greater confidence regarding non-discriminatory treatment without allowing unlimited treaty shopping.
- It can preserve the ability of India to negotiate different commitments with different countries based on strategic, economic or reciprocal considerations.
- Clear drafting could reduce uncertainty and minimise inconsistent interpretations by arbitral tribunals.

Proposed Changes to Investor-State Dispute Settlement (ISDS):

Reduction in Domestic Remedies Period:

- The proposed framework seeks to reduce the period during which investors must pursue domestic legal remedies before initiating international arbitration from **five years to one year**.
- The objective is to reduce delays and make investment-related dispute resolution more efficient.

Institutional Challenge:

- A shorter domestic remedies period would increase the importance of efficient **Indian courts, tribunals and alternative dispute-resolution mechanisms**.
- Unless domestic dispute-resolution institutions can resolve commercial and investment disputes efficiently, investors may still prefer international arbitration after the one-year period.
- The global importance of ISDS reform has increased significantly; UNCTAD recorded more than **1,300 known treaty-based ISDS cases by the end of 2023**, while UNCITRAL continues its multilateral work on ISDS reform.

Longer Post-Treaty Protection:

Proposed Survival Period:

- The draft proposal seeks to extend investor protection after the expiry or termination of a BIT from **five years to 10 years**.
- Such provisions are commonly intended to provide continuity and legal certainty for investments made while the treaty was operational.

Policy Implication:

- A longer survival period can increase investor confidence by reducing the risk that treaty protection will disappear immediately after termination.
- However, it can also prolong a State's exposure to treaty obligations after its investment policy priorities have changed.

Wider Definition of Investment:

Proposed Expansion:

- The revised framework may expand the definition of **investment** to include **portfolio investments and other financial assets**.
- This could potentially extend treaty protection beyond traditional foreign direct investment involving substantial ownership, management or long-term commercial presence.

Implications:

- Minority shareholdings and certain financial interests may potentially receive treaty protection, depending on the final wording.
- A wider definition could increase investor confidence and expand the range of protected capital flows.
- At the same time, broader coverage could increase the number and complexity of potential investment disputes.

Ban on Third-Party Funding:

Meaning:

- **Third-party funding** occurs when an external entity finances an investor's legal claim in return for a potential share of the compensation awarded.
- The proposed framework seeks to prohibit such funding in investment-related litigation or arbitration.

Rationale:

- The measure may discourage speculative or commercially motivated investment claims.
- It could reduce conflicts of interest and concerns regarding excessive litigation.
- However, restrictions may also affect smaller investors that lack sufficient financial resources to pursue legitimate claims.

India's Investment Policy Context:

Need for Greater Predictability:

- Investment decisions depend not only on market size and economic opportunities but also on **legal certainty, regulatory consistency and dispute-resolution mechanisms**.
- India's revised BIT framework is therefore relevant to its broader objective of attracting productive and long-term foreign investment.
- India's international investment treaty network has continued to evolve, while new investment agreements are increasingly being linked with wider economic partnerships and trade arrangements.

Growing Overseas Investments by Indian Companies:

- Indian companies are increasingly investing and operating in foreign markets, making investment protection important not only for inward investment but also for **Indian investors abroad**.

- A stronger and carefully negotiated BIT network can therefore provide India with reciprocal negotiating leverage while protecting legitimate overseas investments of Indian enterprises.

Strategic Balance Between Investor Protection and Sovereignty:

Arguments Supporting Reform:

- **Investor confidence:** Clear treaty protections can reduce uncertainty associated with arbitrary or discriminatory treatment.
- **FDI attractiveness:** A predictable investment regime can improve India's competitiveness as an investment destination.
- **Reciprocity:** Indian investors abroad may benefit when India negotiates stronger and balanced protections with major partner economies.
- **Reduced ambiguity:** Carefully drafted qualifications can reduce inconsistent arbitral interpretations.
- **Efficient dispute settlement:** Reforms can attempt to reduce prolonged uncertainty for both investors and the State.

Concerns Requiring Caution:

- **Regulatory chill:** Excessively broad investment protections may discourage governments from adopting legitimate regulations in areas such as environment, taxation, public health and welfare.
- **Fiscal exposure:** Adverse arbitral awards can create significant financial liabilities for the State.
- **Expanded litigation:** A wider definition of investment could enlarge the pool of potential claimants.
- **Institutional weakness:** Shorter domestic-remedy periods require stronger domestic mechanisms for commercial dispute resolution.
- **Drafting ambiguity:** Poorly drafted Qualified MFN provisions could recreate the interpretative uncertainty that the reform seeks to prevent.

Way Forward:

Design a Precisely Drafted Qualified MFN Clause:

- India should clearly define the **scope, beneficiaries, comparator, temporal application and exclusions** applicable to MFN treatment.
- The treaty should explicitly state whether MFN treatment applies to substantive investment protection, ISDS provisions or both.

Strengthen Domestic Dispute Resolution:

- Commercial courts and specialised dispute-resolution mechanisms should be strengthened to ensure faster and predictable outcomes.
- Greater institutional efficiency would reduce excessive dependence on international arbitration.

Protect Legitimate Public Policy Regulation:

- BITs should clearly preserve the State's **right to regulate** for public health, environmental protection, national security, financial stability and social welfare.
- Treaty drafting should distinguish between legitimate regulation and genuinely discriminatory or arbitrary State conduct.

Adopt a Calibrated Investment Definition:

- Any expansion to portfolio investment should contain appropriate thresholds and exclusions.

- Protection should not unintentionally cover speculative or purely temporary capital movements in the same manner as long-term productive investment.

Ensure Treaty Consistency:

- India's future BITs should maintain sufficient consistency to reduce fragmentation and contradictory interpretations.
- At the same time, country-specific flexibility should remain available where justified by reciprocity and strategic interests.

Value Addition for UPSC:

Prelims Pointers:

- **BIT:** Agreement between two countries governing protection and treatment of investments.
- **MFN:** Principle requiring non-discriminatory treatment compared with investors from other treaty partners.
- **FET:** Fair and Equitable Treatment standard used in investment treaties.
- **ISDS:** Mechanism through which foreign investors may bring treaty-based claims against host States.
- **Model BIT 2015:** India's framework emphasising greater regulatory autonomy and narrower investor protections.

Potential UPSC Mains Question: *"Bilateral Investment Treaties can promote investor confidence but may also constrain the regulatory autonomy of developing countries. Examine the significance of India's proposed Qualified MFN approach in achieving an appropriate balance."*